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SUBJECT: MONTERREY: A NAFTA SUCCESS STORY

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1. (SBU) Summary. The state of Nuevo Leon and its capital city of Monterrey have benefited greatly from NAFTA, with huge leaps in manufacturing exports and employment. Nuevo Leon faces stiff international competition on basic manufactured goods but hopes to move to higher value added products. In the political realm, there is a pro-business consensus between the local PAN and PRI politicians, while the left-wing PRD has little influence. Although Nuevo Leon recognizes that there is an economic gap between Northern and Southern Mexico, it does not see additional aid flowing to the poor states in the South as a solution. Instead, leaders here believe that the South should improve its work ethic and business climate to resemble Nuevo Leon. Nuevo Leon is truly an example of NAFTA success, but its transformation is remains incomplete; the state still suffers from the common Mexican maladies of monopolies, high energy prices, corruption and lack of security. End Summary.

2. (U) Nuevo Leon lies in a rugged desert terrain with few natural resources. This area was sparsely populated from Mayan times until the 19th century. The people of Nuevo Leon boast that the harsh environment created a strong work ethic that has helped them build an industrial economy. Industrial growth began in the 19th century, first when Monterrey served as a staging ground for funneling goods to the Confederacy during the U.S. Civil War and later through the establishment of a steel industry and brewery. These industrialists furthered Monterrey's development by founding the Monterrey Technological Institute (Monterrey Tec), a highly regarded private university system, to train managers and engineers. Nuevo Leon is also strategically located on trade routes into the United States. Therefore, as Mexico has opened its economy, Nuevo Leon was well positioned to capitalize on its industrial base and location to export goods to the United States.

Nuevo Leon's Economic Success

3. (U) Nuevo Leon has consistently outperformed Mexico in terms of per capita income, economic growth, investment, education, and poverty reduction. According to statistics from the Nuevo Leon Secretary of Economic Development (SEDEC), Nuevo Leon had a per capita gross domestic product (GDP) of \$13,096 compared to \$8,135 in Mexico overall in 2006. The population of Nuevo Leon is 4 million people, of which approximately 80% live in the Monterrey metropolitan area. However, although only 4% of Mexicans live in Nuevo Leon, according to data from the

Mexican Secretary for Economic Development, Nuevo Leon accounts for 7.5% of Mexico's GDP, and 9.9% of its manufacturing. Moreover, Nuevo Leon's economy has consistently grown faster than Mexico as a whole. Nuevo Leon achieved an average 4.2% GDP growth from 2000-2006, compared to Mexico's overall 2.9% overall growth rate, calculated by averaging the growth from 2000 to 2006. Nuevo Leon's manufacturing industry grew 2.8% per annum from 2000-2006 compared to the national average of 1.6%. Note. Several Nuevo Leon sources offered slightly different statistics, so we used the more conservative figures. End Note.

14. (U) Nuevo Leon has also captured a robust share of foreign direct investment (FDI) harvested by Mexico since the inception of NAFTA. According to the Mexican Secretary of the Economy, from 1994 to 2006 the Federal District (Mexico City) received 57% of FDI, followed by Nuevo Leon with 11%, the State of Mexico 6% (located adjacent to the Federal District), Baja California 5%, Chihuahua 5%, Jalisco 3% and the other 26 states received 13% of FDI. Nuevo Leon did even better in 2007, attracting \$1.8 billion in FDI, a 26% increase over 2006, and according to state officials these investments have reportedly created 13,000 jobs. Moreover, the Nuevo Leon Maquila Association expects 14 maquilas to invest between \$350 and \$550 million in Nuevo Leon in 2008, emphasizing automotive, aerospace and metals. The FDI investment in Nuevo Leon has long been concentrated in industrial manufacturing, although there have also been significant investments in financial services. In 2006, for example, 75% of the FDI was invested in industrial manufacturing and 16.5% in financial services.

15. (U) Nuevo Leon has greatly increased its export manufacturing sector since 1995, demonstrating the benefits of NAFTA. According to Nuevo Leon numbers, from 1995 to 2006 the number of Maquila companies manufacturing for export increased from 84 to 208 (147% increase), the number of employees rose from 27,116 to 72,472 (167%), they increased their imports of inputs from 6,090,451 to 54,881,488 millions of pesos (801%), and their value added increased from 1,646,625 to 23,919,706 millions of pesos (1,353%). Interestingly, the ratio of Mexican value added to total value (including imported inputs) increased from 22% to 29% from 1994 to 2000, but only rose to 30% by 2006,

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suggesting that Mexico has not moved strongly to develop supplier industries.

16. (U) Nuevo Leon's overall manufacturing has also increased, although more modestly than export production. According to the National Institute of Statistics, Geography and Information (INEGI), Nuevo Leon's overall manufacturing employment increased from 142,553 in 1995 to 159,785 in 2006, a modest 12% increase, and the value of manufacturing products rose from 56,931,687 million pesos in 1995 to 248,783,799 in 2006, a 336% increase. The small increase in overall manufacturing employment suggests either increased productivity or a decline in manufacturing production for the domestic market. INEGI reports that manufacturing provided 33% of the formal employment in Nuevo Leon, followed by business and personal services (24%), commerce (19%), construction (10%), transport and communications (7%), social services (7%), and agriculture and mining combined provide only 1% of employment. In the formal sector Nuevo Leon's manufacturing jobs are primarily permanent, comprising 84% of the jobs, but that is slowly decreasing. In 2006 Nuevo Leon created 73,218 formal jobs, but only 42,740 (58%) were permanent, so temporary employment is increasing its share.

Educational and Poverty Reduction Success by Mexican Standards

17. (U) Nuevo Leon also surpasses the national averages for education, although the results are still poor in comparison to international standards. The average Nuevo Leon worker has 10.1 years of formal education, higher than the national average of 8.7 years. According to the international test PISA 2006 of 15 year olds, Nuevo Leon scores the highest of all 32 Mexican states in reading, is 3rd in math and ranks 4th in science. However, Nuevo Leon's academic achievements are still low. In

reading, for example, 29% of students score at levels 0 to 1 (insufficient to advance in school and work in a knowledge society), 32% were at level 2 (the minimum adequate in contemporary society), 37% were in levels 3 to 4 (good but below the highest cognitive level) and only 1.5% at the highest level 5. Similarly, in math 45% of Nuevo Leon students were in levels 0-1, 29% in level 2, 25% in levels 3-4, and only .8% in level 5.

The scores were much the same in science, where 37% of students were in level 0-1, 37% in level 2, 26% in level 3-4, and only .3% in the highest level 5. Similarly poor results were shown in the 2006 ENLACE test, with students performing at significantly worse levels in Spanish and math in secondary school than in primary school, indicating that students fall behind international standards while enrolled in Nuevo Leon schools.

18. (SBU) Nuevo Leon scores higher than the national average in technical education, educating 17% of the total of all Mexican students (defined as industrial or commercial training after 9th grade). However, Nuevo Leon was only slightly above average for university and postgraduate studies (6% of Mexico's total), but slightly below average in professional technicians (students with 2-3 years of education beyond high school), with 3% of the Mexican total, and only 621 professional technicians graduated in 2006. The relative lack of professional technicians tracks comments from businesses that it is hard to attract highly trained technicians, because educated Mexicans aspire to business or law degrees. Nuevo Leon does have several strong universities, led by the private Monterrey Tec, the University of Monterrey, and the state Autonomous University of Nuevo Leon, and Nuevo Leon has over 150,000 university students. There are also several prestigious business schools. The U.S. firm Halliburton has sought to take advantage of the supply of trained English-speaking engineers here by outsourcing some of its petroleum work to Monterrey. The Indian software giant Infosys told Econoff that they have been pleased with their recruits from Nuevo Leon. Infosys gives all of its candidates a test for technical proficiency, and the Mexican engineers have tested at a similar level as the engineers in India.

19. (U) Nuevo Leon's wealth is also reflected in its relatively low poverty rates. Among Mexican states, Nuevo Leon has the third lowest level of poverty in Mexico, 27.5%, far better than the national average of 47%, and the proportion of poor lacking food is even less, with 3.6%, much better than the national average of 18.2%. In Nuevo Leon only 2.77% of the population aged 15 years old and older are illiterate, second to the Federal District, and a nice improvement over the national average of 8.35%. Similarly, Nuevo Leon is substantially better than the national averages in areas such as access to health care, homes with water and garbage pick up, and homes with a refrigerator. In fact, weighing all of these factors, the National Council for Social Development found that Nuevo Leon suffered the least from poverty of all the Mexican states.

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Nuevo Leon's Plans to Move Up in the Manufacturing Value Chain

10. (SBU) Various business leaders believe that Nuevo Leon has been successful due to its strategic location, work ethic, industrial base, business climate, cooperative unions, and relatively high level of education. Nuevo Leon lies on highway and rail networks offering direct access to the United States, offering an enormous comparative advantage for transportation costs and just in time delivery. As to work ethic, Roberto Cavazos, executive director of the American Chamber of Commerce, offered a typical perspective that since Nuevo Leon had few natural resources, the people had to develop a strong work ethic to survive, and this work ethic allowed Nuevo Leon to build an industrial economy. Andres Franco, the sub-secretary at SEDEC in charge of attracting foreign investment, lamented as a Mexican that only 5-6 states are truly competitive in seeking FDI, and most states are not even in the game. In 2006 America Economia magazine declared Monterrey as the third best Latin American city for doing business, after Sao Paulo, Brazil and

Santiago, Chile. Many American business contacts have commented that the Monterrey business culture feels similar to the United States, and they give as examples that meetings start on time and people get right to the point. Indeed, many top Mexican business and political leaders have extensive exposure to the United States through school, vacations or second homes in San Antonio or nearby South Padre Island, Texas. The unions are cooperative, as demonstrated by the fact that Nuevo Leon has not experienced a strike in over nine years, many firms have company controlled "white unions", and even the local chapters of national unions like CTM and CROC work within the local power structure.

¶11. (U) Nuevo Leon hopes to move beyond its traditional manufacturing industries to a knowledge based economy. Nuevo Leon has relatively higher labor costs than China, Central America or even Southern Mexican states. Nuevo Leon officials realize that they face tough international competition in the manufacturing sector from both Asia, particularly China, and the Central American countries now armed with CAFTA benefits. For example, in the textile and apparel industry, Nuevo Leon's manufacturing employment steeply declined from 10,237 in 1995 to 5,524 in 2006. Nuevo Leon has focused on existing industries such as automotive and household appliances, plans to develop an aerospace industry, and has promoted knowledge based industries such as information and communication technologies, health, biotechnology, and nanotechnology. Nuevo Leon has used a new law providing incentives to investors in strategic industries. In addition, Nuevo Leon touts its City of Knowledge research park in its promotion brochures to lure FDI. Nuevo Leon has had some successes, attracting computer manufacturer Lenovo and information technology services firms like India's Infosys. Indeed, according to state figures, although only 2% of the FDI from October 2006 to September 2007 was invested in the software sector, these investments created 16% of the new jobs. See reftels A (investment law), B (City of Knowledge), and C (medical tourism).

Politics Dominated by the PAN and Conservative Wing of the PRI

¶12. (U) The PAN and PRI parties dominate Nuevo Leon politics, and the leftist PRD is only a minor player. The PAN and PRI are both competitive in national and local races, as a PRI Governor replaced a PAN Governor in 2003. However, the PRI's fortunes reversed in the 2006 mid-term elections, where four of PRI Governor Jose Natividad Gonzalez Paras' handpicked candidates for mayor lost to PAN candidates in the Monterrey metropolitan area, and PAN also won a slim majority in the local unicameral legislature. The local PAN and PRI candidates are similar ideologically. For example, PRI Governor Gonzalez loves to discuss how Nuevo Leon will conquer the challenges of globalization and even local unions emphasize education and how they can compete globally. In contrast, the local PRD presence is negligible. The PRD polled approximately 2% in the 1994, 1997, and 2003 elections for federal deputies, although they achieved 7% in alliance with the PT (Workers Party). The PT is actually stronger locally, receiving 5% of the vote in the 1997 and 2003 elections for federal deputies. Similarly, the PRD/PT alliance received only 9% of the vote in the 2000 Presidential election. However, buoyed by the popularity of PRD Presidential candidate Andres Manuel Lopez Obrador (AMLO), the leftist alliance collected 16% of the vote in 2006, but AMLO's coattails did not extend to local candidates, where the PRD/PT alliance fell to 9% for federal deputies and 8% for federal senators in the 2006 election. The PRD is also very weak in local elections, only gaining 1% in the 2003 Governor's race, and currently has only 1 local deputy (elected on a proportional

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vote) in the local legislature. During the massive 2006 election protests in Mexico City, the local PRD mounted only token protests which were roundly ignored by the general populace.

Nuevo Leon to the Rest of Mexico: Catch Up

¶13. (SBU) Nuevo Leon generally prefers to look North to the United States rather than South to Mexico City. Nuevo Leon leaders often emphasize their ties to the United States rather than Mexico. For example, several leaders claim that in terms of GDP, Nuevo Leon is closer to Mississippi and Louisiana than Southern Mexico, and contacts often note the regional economic integration between Northern Mexico and Texas. Econoff has spoken to a variety of political and business contacts about the gap between Nuevo Leon and the rest of Mexico. Their uniform prescription is to criticize Southern Mexico as backward, and recommend that Southern and Central Mexico adopt (in their view) Nuevo Leon's superior work ethic and business climate. For example, business leaders often hold up the example of Oaxaca, where political turmoil and demonstrations damaged tourism, their only viable industry. Several contacts also complained that the federal government takes far more in taxes from Nuevo Leon than it returns, and they see the money as often wasted by the federal government. None of our contacts support additional taxes to provide more resources for Southern Mexico, although several wistfully hope for a U.S. Marshall Plan for Mexico. Indeed, several contacts believe that it will be many years before the South can catch up to Northern Mexico, and they seem far more interested in advancing Nuevo Leon's economic integration with Texas than sacrificing to modernize Southern Mexico.

¶14. (SBU) Comment. Nuevo Leon has been a NAFTA success story, but it is not necessarily a template for reform. Nuevo Leon achieved its successes through manufacturing but has not engaged in the fundamental reforms needed to transform Mexico (see reftels D and E). It still suffers from the same constraints as the rest of Mexico, including high energy prices, antiquated labor laws, the predominance of public and private monopolies in many sectors of the economy, poor public education and graft. Many business visitors are initially dazzled by the infrastructure and Monterrey's material success, but as they look deeper they begin to see corruption, security problems and lack of opportunities for poor Mexicans that lie beneath the flashy facade. Monterrey has certainly been successful by Mexican standards, but fundamental changes are still needed to reach their goal of becoming a true first world city.

¶15. (SBU) Comment continued. In terms of politics, the PAN and Northern PRI have similar economic beliefs, as both profess a commitment to provide more and better jobs through increased international competitiveness. Nuevo Leon does not have a viable leftist party, and the local political actors rarely ask how to broaden economic opportunities to the poor or grapple with the problems of poverty, although 27% of the population is below the poverty level. The similarity between the parties provides for a stable business climate, but is not conducive to addressing fundamental inequities in the system. End Comment.
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